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No. 94 267

In The

Supreme Court of the United States

October Term, 1994

In re: EDWARD W. TOTI,

Debtor.

EDWARD W. TOTI,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Did the District Court and the Court of Appeals err in the interpretation of 11 U.S.C. § 523(a)(1)(C) by denying a bankruptcy debtor discharge of unpaid income tax liabilities reflected on deliquently filed returns where the debtor did not commit tax evasion or any act of evasion-motivated conduct as contemplated by the statute?

LIST OF PARTIES

1. Edward T. Toti

2. United States of America, Internal Revenue Service

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Matter of Toti, 141 B.R. 126 (Bkrtcy. E.D. Mich. 1992);

United States v. Toti, 149 B.R. 829 (D.C. E.D. Mich. 1993);

Toti v. United States of America (In re Toti), __ F.3d __, No. 93-1206 (6th Cir., May 13, 1994).

STATEMENT OF JURISDICTION

The decision from which this petition for a writ of certiorari is taken was made and filed on May 13, 1994.

Jurisdiction is conferred upon this Court under the Constitution of the United States, Article III, Section 2. Jurisdiction is also conferred pursuant to 28 U.S.C. § 1254(1):

> Cases in the courts of appeal may be reviewed by the Supreme Court by the following methods:
>
> > (1) by writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree.

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED

United States Constitution:

Article I, Section 8

> The Congress shall have power to . . . establish . . . uniform laws on the subject of bankruptcies through the United States . . .

Statutes:

11 U.S.C. §§ 727(a) and (b)

(a) The Court shall grant the debtor a discharge . . .

* * *

(b) Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter, and any liability on a claim that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title, and whether or not a claim based on any such debt or liability is allowed under section 502 of this title.

11 U.S.C. § 523(a)

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —

(1) for a tax or customs duty —

(A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(7) of this title, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, if required —

(i) was not filed; or

(ii) was filed after the date on which such return was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

11 U.S.C. § 507(a)(2)

(a) The following expenses and claims have priority in the following order:

* * *

(2) Second, unsecured claims allowed under section 502(f) of this title.

11 U.S.C. § 507(a)(7)

(7) Seventh, allowed unsecured claims of governmental units; only to the extent that such claims are for —

(A) a tax on or measured by income or gross receipts —

(i) for a taxable year ending on

> or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;
>
> (ii) assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition.

11 U.S.C. § 502(f)

> (f) In an involuntary case, a claim arising in the ordinary course of the debtor's business or financial affairs after the commencement of the case but before the earlier of the appointment of a trustee and the order for relief shall be determined as of the date such claim arises, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

26 U.S.C. § 7201

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony, and upon conviction thereof,

> shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.

26 U.S.C. § 7203

> Any person required under this title to pay any estimated tax or tax, or required by this title or by regulations under authority thereof to make a return, keep any records, or supply any information, at the time or times required by law or regulations, shall, in addition to other penalty provided by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than $25,000.00 ($100,000.00 in the case of a corporation), or imprisoned not more than one year, or both, together with the costs of prosecution.

STATEMENT OF FACTS

A. Introduction

This case presents the first opportunity for this Court to review the actions of the lower Article III courts, reversing the Bankruptcy Court, restricting the remedial purposes of the Bankruptcy Code by denying discharge to a debtor who failed to timely file tax returns years before seeking bankruptcy protection. The debtor filed all required returns and attempted to make payments before filing bankruptcy. No other lower courts have ever made such an expansive reading of 11 U.S.C. § 523(a)(1)(C) to deny discharge where the debtor did not engage in acts of tax evasion or evasion motivated conduct. The Court of Appeals for the Sixth Court's interpretation of "willful" within the meaning of 11 U.S.C.

§ 523(a)(1) conflicts with the decision of this Court in *Spies v. United States*, 317 U.S. 492, 63 S.Ct. 364 (1943).

B. The Petitioner's Tax History

The parties do not dispute the essential facts in this matter. The petitioner, Edward W. Toti, ("Toti"), during his working life in the 1960's and 1970's, was a self-employed independent insurance agent. He is now seventy years of age and retired. From 1961 to 1973, Toti, timely filed all of his federal income tax returns and paid any and all taxes owed to the Internal Revenue Service. In 1975, because of his lack of funds, Toti did not file a return for calendar year 1974. Toti again was unable to pay his federal income tax liability for the 1975 year and did not file a return for that period. Toti became fearful of the accrual of penalties and interest for the unfiled years and continued his non-filing through calendar year 1980.

In 1981, the government charged Toti with three counts of failure to file federal income tax returns respecting the years 1974, 1975 and 1976 in the United States District Court for the Eastern District of Michigan. Toti agreed, pursuant to a plea agreement, to plead guilty to willfully failing to file an income tax return for the year 1976. On June 4, 1981, Toti was sentenced to one year imprisonment with all but sixty (60) days suspended, and he was ordered to file all delinquent returns and pay the tax due for the 1976 year. The Government dismissed the charges with respect to the 1974 and 1975 years.

Following his conviction in 1982, Toti filed all of the delinquent federal income tax returns for the years 1974 through 1981. He paid his entire 1976 federal income tax liability, together with accrued interest and penalties; however, he did not pay the tax liabilities for the other years for which he had filed delinquent returns.

Because he was unable to pay the liabilities, Toti negotiated a payment plan with the Internal Revenue Service in April, 1985. While Toti made some of the payments timely, he was unable to make others for lack of funds. The Internal Revenue Service then began enforced collection activity in 1989, levying upon his pension income, causing him serious financial difficulties.

C. Proceedings in the Lower Courts

On February 27, 1990, Toti filed a Chapter 7 Petition in the United States Bankruptcy Court. On March 28, 1990, Toti filed an adversary proceeding to determine the dischargeability of tax obligations for unpaid federal income taxes for the tax years 1975 through 1983, excluding the year 1976 which he had paid, and to require the Internal Revenue Service to turn over funds in the amount of $4,464.39 which had been levied by it post-petition. Toti also sought damages against the Internal Revenue Service for violation of the automatic stay by reason of its post-petition actions in levying upon his pension income.

Following the filing and hearing on cross-motions for summary judgment, the Bankruptcy Court on May 22, 1992, issued its opinion in respect to those motions. The Bankruptcy Court found that Toti's income tax liabilities for the tax years 1974 through 1983 (excluding the year 1976, which was paid) were discharged by Toti's bankruptcy. It held that Toti's failures to timely file the tax returns that were delinquently filed did not except the Government's claim from discharge under 11 U.S.C. § 523(a)(1)(C). A final order was entered on June 16, 1992. The Government filed a Motion to Alter or Amend the Judgment, which was denied by the Bankruptcy Court on June 30, 1992.

On July 7, 1992, the Government filed its appeal to the United States District Court for the Eastern District of Michigan. On January 7, 1993, following oral argument, the District Court

reversed the Bankruptcy Court decision, ruling that Toti's tax liabilities could not be discharged in bankruptcy.

On February 3, 1993, Toti filed an appeal to the Sixth Circuit Court of Appeals from the District Court's Memorandum Opinion and Order. The Court of Appeals affirmed the District Court in its decision dated May 13, 1994.

D. Basis for Federal Court Jurisdiction in the Court of First Instance

The Bankruptcy Court had jurisdiction over this dischargeability case pursuant to 28 U.S.C. § 1334(a), § 157(a), § 157(b)(1) and § 157(b)(2)(I).

REASONS FOR GRANTING THE WRIT

The United States Court of Appeals for the Sixth Circuit has decided an important question of federal bankruptcy law respecting dischargeability, which has not been, but should be, settled by this Court. In doing so, it interpreted 11 U.S.C. § 523 in a way that conflicts with long-established precedent of this Court found in *Spies v. United States*, 317 U.S. 492, 63 S. Ct. 364 (1943) and *Sansone v. United States*, 380 U.S. 343, 85 S. Ct. 1004 (1965) which distinguished the conduct punishable as a willful failure to file from the more serious conduct subject to felony sanctions.

The Court of Appeals defined the term "willful" in a way that re-defines the elements of or supplies additional elements to 11 U.S.C. § 523(a)(1) which are not within the plain reading of the statute. This redefinition of the elements of the tax dischargeability provisions of the Bankruptcy Code is contrary to the definition of willfulness in *Spies*, as further refined in *United States v. Bishop*, 412 U.S. 346, 93 S. Ct. 2008 (1973); *United States v. Pomponio*, 429 U.S. 10, 97 S. Ct. 22 (1976); and *Cheek v. United States*, 498 U.S. 192, 111 S. Ct. 604 (1991). The Court of Appeals decision, for

the first time, denies a bankruptcy debtor the ability to discharge his or her personal liability for income taxes where that person merely fails to file and undertakes no more aggravated conduct. Moreover, the Court of Appeals would deny discharge of those liabilities after a person has attempted, albeit unsuccessfully, to file delinquent returns and pay the taxes owed. This result is contrary to the broad remedial purposes of the Bankruptcy Code and the plain language of 11 U.S.C. § 523. The expansive interpretation of the word "willful" by the Court of Appeals, if sustained, potentially permits the lower courts to deny discharge to all bankruptcy debtors who filed tax returns, however shortly after the filing deadlines, and are unable to pay taxes due thereon.

I.

THE STATUTORY SCHEME OF THE BANKRUPTCY CODE.

11 U.S.C. § 523 is part of the statutory scheme under which a debtor will be granted a discharge of and from all pre-petition debts unless a particular debt is specifically excepted from discharge under that section. Section 523(a)(1) is a fairly elaborate non-dischargeability provision, enumerating those circumstances excepting a tax or custom duty from discharge under the Bankruptcy Code. A tax debt *is* dischargeable by a debtor unless the debt is for a tax or a customs duty which is a priority tax, enumerated in §§ 507(a)(2) or (a)(7); unless it is a tax with respect to which a return, if required, was not filed or was filed less than two (2) years before the filing of bankruptcy petition; or unless "with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax."

Reading § 523 with §§ 507(a)(2) and 507(a)(7), the statutory scheme provides that a debtor may discharge an income tax liability if:

> (1) The tax is more than three (3) years old measured from the date the return was last due, without extension; and
>
> (2) The debtor filed his return; and
>
> (3) If the debtor did not timely file his tax return, such return was filed at least two (2) years before the filing of the bankruptcy petition; and
>
> (4) If the return was filed, and an additional tax was assessed, the bankruptcy petition was filed more than 240 days after the additional tax was assessed; and
>
> (5) The debtor did not make a fraudulent return or willfully attempt in any manner to evade or defeat such tax.

See Sprayregen, "Dischargeability of Personal Income Taxes in Bankruptcy" 64 Am. Bankruptcy L.J. 209, 210 (1990).

Section 523(a)(1)(B)(ii) addresses those instances where a return is filed delinquently and, if not a priority tax, as defined under §§ 507(a)(2) or (a)(7), provides for the discharge of those taxes unless the delinquent returns were filed within two (2) years before the date of the filing of the petition in bankruptcy. Edward Toti satisfied all of the above-stated conditions to discharge his tax liability in bankruptcy. He did not timely file his tax returns, nor did he pay the taxes due for those years, but he did file complete and truthful tax returns more than two (2) years before the filing of the bankruptcy petition. Other than his conscious, *i.e.*, "willful," failure to file returns and pay the taxes shown due thereon, he undertook no activity attempting to falsify, convey, mislead,

conceal, avoid, manipulate, secrete or engage in any other act of tax evasion motivated conduct. Toti undertook none of the affirmative acts of evasion motivated conduct enumerated in *Spies*, 317 U.S. at 499, 63 S. Ct. at 368.

The Court of Appeals for the Sixth Circuit expanded § 523(a)(1)(C) in its decision denying Toti a discharge of his tax liabilities. The Court of Appeals focused its attention on the definition of the term "willful" in § 523(a)(1)(C). It defined the term as it applied in civil cases as the "voluntary, conscious and intentional evasions of tax liabilities." *In re Toti*, __ F.3d __, No. 93-1026 (6th Cir. 1994) (App. p. 6a). The definition of "willfulness" is not in dispute. Petitioner accepts this as the proper reading and application of this term; however, the Court of Appeals went one step further. It included the acts of "failure to file" tax returns and "failure to pay" a tax within the definition of "evade or defeat." This is a confusion of the concepts of *mens rea* or intent with the *actus rea* or prohibited criminal conduct which provides grounds for denying discharge. In *Toti* the true issue is what constitutes the elements of the debtor's attempt in any manner to "evade or defeat such tax." Only if the debtor committed those wrongful acts do we then examine whether the debtor did so "willfully" as that term is defined.

The language of § 523(a)(1)(C) is identical to and parrots 26 U.S.C. § 7201, the provision of the Internal Revenue Code making it a crime to willfully attempt to evade or defeat a tax or payment thereof. Section 7201 provides:

> Any person who *willfully attempts in any manner to evade or defeat any tax* imposed by this title *or the payment thereof*, shall in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000

> ($500,000 in the case of a corporation), or imprisoned not more than five (5) years or both, together with the cost of prosecution.

(Emphasis supplied).

Section 7201 is a felony. Toti was charged with and convicted of failure to file his income tax return for 1976 under 26 U.S.C. § 7203. Section 7203 is a misdemeanor and provides:

> Any person required under this title to pay any estimated taxes or tax, required by this title or by regulations under authority thereof to make a return, keep any records or supply any information, *who willfully fails to pay such estimated tax, make such a return, keep such records or supply such information,* at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined of not more than $25,000 ($100,000 in the case of a corporation), or imprisoned not more than one year, or both, together with the cost of prosecution.

(Emphasis supplied).

II.

CONFLICT WITH PRIOR PRECEDENT OF THIS COURT.

This Court has defined "willfulness" consistently and most recently in 1991 in interpreting the tax enforcement statutes to

mean the "voluntary, intentional, violation of a known legal duty." *See Cheek v. United States*, 498 U.S. 192, 111 S. Ct. 604 (1991); *United States v. Pomponio*, 429 U.S. 10, 97 S. Ct. 22 (1976); *Bishop v. United States*, 412 U.S. 346, 93 S. Ct. 2008 (1973). None of those cases disturbed the distinction between misdemeanor and felony conduct enunciated by the Supreme Court in *Spies v. United States*, 317 U.S. 492, 63 S. Ct. 364 (1943), over 50 years ago. In *Spies*, the defendant was convicted of willfully attempting to evade or defeat the tax, the felony provision. He had sufficient income to file a tax return, pay the tax due, but he failed to do both. The Government contended that the willful failure to file and pay constituted an attempt to evade, a felony. This Court rejected that argument and reversed the conviction stating:

> The difference between willful failure to pay a tax when due, which is made a misdemeanor, and willful attempt to defeat and evade one, which is made a felony, is not easy to detect or define. Both must be willful, and willful, as we said, is a word of many meanings, its construction often being influenced by its content . . . in view of our traditional aversion to imprisonment for debt, we would not without the clearest manifestation of congressional intent assume that mere knowing an intentional default in payment of a tax where there had been no willful failure to disclose the liability is intended to constitute a criminal offense of any degree. We would expect willfulness in such a case to include some element of evil motive and want of justification in view of all the financial circumstances of the taxpayer.

Spies, 317 U.S. at 498, 63 S. Ct. at 367.

This Court held that to be liable for the crime of tax evasion, the taxpayer must commit an affirmative act of evasion motivated conduct, not just willfully fail to file a return or pay the tax, which would be willful omissions to act. It stated:

> Congress did not define or limit the methods by which a willful attempt to defeat and evade might be accomplished and perhaps did not define less its efforts to do so results in some unexpected limitation. Nor would we by definition constrict the scope of the congressional provision that it may be accomplished "in any manner." By way illustration and not by way of limitation, we would think *affirmative willful attempt may be inferred from conduct* such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering-up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, with the likely effect of which would be to mislead or conceal.

(Emphasis supplied). *Id.* 317 U.S. at 499, 63 S. Ct. at 368.

The distinction between the language in the Internal Revenue Code felony provision found in § 7201 from that found in the misdemeanor failure to file and pay provision, § 7203, was reiterated by this Court in *Sansone v. United States*, 380 U.S. 343, 85 S. Ct. 1004 (1965). Sansone was charged with tax evasion, the felony provision, for the years 1956 and 1957 by filing false returns omitting the sale of real estate and thereby under reporting the tax due on each of the returns. Sansone sought to have the jury

instructed on the lesser-included misdemeanor offenses of willfully filing a fraudulent or false return in violation of § 7207 or willfully failing to pay his tax in violation of § 7203. This Court affirmed the denial of the lower court's refusal to require instruction on the lesser-included offenses. There were no disputed issues of fact to justify finding Sansone had committed all the elements of either or both § 7203 or § 7207 without having committed a violation of the § 7201 felony. The issue for the jury was purely whether or not Sansone acted "willfully." This Court analyzed each of the elements of the § 7201 felony and the tax misdemeanors noting that the element of willfulness was common to all statutes. In contrast, the Court noted, the § 7201 felony also required an affirmative act constituting an evasion or attempted evasion of the tax, citing *Spies. Sansone,* 380 U.S. at 349, 85 S. Ct. at 1009. Consistent application of this long line of precedent requires reversal of the denial of bankruptcy discharge where Toti committed no acts of tax evasion or evasion motivated conduct.

Other lower courts have addressed the non-dischargeability provision in § 523(a)(1)(C) but have never extended it as far as the Court of Appeals for the Sixth Circuit did in this instance. The Bankruptcy Court for the District of Oregon in *In re Garthwright,* 102 B.R. 211 (Bkrtcy. D. Ore. 1989), analyzed the non-dischargeability of taxes under § 523(a)(1) and distinguished the acts of evasion and intent in accordance with *Spies.* Even those cases which purport to follow the rationale of the district court in *Toti* have found other action justifying the denial of discharge of the tax liabilities under § 523(a)(1)(C) where the debtor engages in tax evasion motivated conduct. *See In re Lilley,* 162 B.R. 715 (Bkrtcy. E.D. Pa. 1993) (filing a false W-4E [Exemptions from Withholding], and knowingly claiming false deductions to avoid payment of taxes); *In re Jones,* 116 B.R. 810 (Bkrtcy. D. Kan. 1990) (debtors actively concealed their ownership of two pieces of real estate with the intent of avoiding payment of taxes); *In re Irvine,* 163 B.R. 983, 987 (Bkrtcy. E.D. Pa. 1994) (badges of fraud

found where there was purposeful intent to conceal embezzled funds); *In re Sumpter,* 136 B.R. 690 (Bkrtcy. E.D. Mich. 1991) (badges of fraud found where debtors engaged in transfers of valuable properties into family trusts and granted questionable mortgages in an attempt to reduce the equity in the properties); *In re Berson,* 145 B.R. 247 (Bkrtcy. N.D. Ill. 1992) (badges of fraud found where failure to file was coupled with understatement of income on returns that were filed and debtor's paychecks were deposited into wife's bank account to hide the money from the Internal Revenue Service).

The Court of Appeals' decision creates the potential of confusion in the application of the Bankruptcy Code. In denying the discharge on these facts, the Court of Appeals disregarded its own announcement "that courts should interpret the Bankruptcy Code according to the plain meaning of an individual provision as long as the provision's language is unambiguous." *In re Toti,* __ F.3d __, No. 93-1026 (6th Cir. 1994) (App. 10a), *citing United States v. Ron Pair Enterprises,* 489 U.S. 235, 240 (1989). By defining "willful" to include as an element of § 523(a)(1)(C), the failure to file and pay a tax, the Court has read into the statute elements which do not appear within the plain reading of it.[1]

---

1. As this Court has recently noted, the term "willful" should be construed the same way each time that it appears, and that "reading the word differently for each Code Section to which it applies — would open Pandora's jar. Courts can render meanings so malleable, the usefulness of a single penalty provision for a group of related code sections will be eviscerated and . . . almost any code section that can reference a group of other code sections would become susceptible to individual interpretation." *Ratzlaf v. United States,* __ U.S. __, 114, S. Ct. 655, 660 (1994).

III.

APPLICATION OF SECTION 523(a)(1)(B)(ii).

Moreover, and importantly, the Court of Appeals' decision in *Toti* barring discharge of tax liabilities, where there is merely a failure to timely file a tax return pursuant to § 523(a)(1)(C), cannot be harmonized with § 523(a)(1)(B)(ii). That section permits the discharge of unpaid taxes for which delinquent returns have been filed more than two years before the date of the filing of the bankruptcy petition. In this provision, Congress has set forth the limitations on the discharge of delinquent tax liabilities where a fraudulent return was not filed and no willful attempt in any manner to evade or defeat the tax was undertaken. The reasoning of the Court of Appeals renders this provision of the Bankruptcy Code a nullity by its expansive reading of § 523(a)(1)(C). Under *Toti* virtually every mere failure to file, even though corrected by the filing of delinquent returns and attempts to pay the taxes, civil penalties, and interest, would be grounds to deny discharge.

CONCLUSION

Toti's failure to file his returns or pay the taxes is not to be condoned. However, those returns were filed more than two years prior to the filing of the bankruptcy petition. He made efforts to repay the tax debt, but later defaulted due to his later reduced income. By defining the term "willful" so broadly, the Court of Appeals has invalidated the dischargeability provision to deny any debtor the ability to discharge his tax debt, even where he has satisfied all the other conditions of § 523(a)(1). It could not be seriously stated that any reasonable citizen in this country is unaware of his or her duty to pay taxes. If true, then any debtor who has failed to pay such taxes, but has *some* ability to pay can never discharge the liability. However, the person who has no income or other assets to pay the tax debt is either uncollectible, and not in

need of the protection of the bankruptcy laws, or is unlikely to have an income tax liability to begin with. The failure to file or pay one's taxes makes one *a priori* a "dishonest debtor" unless the debtor is blind to one of the basic commandments of government to pay tribute. This is not the lesson of *Spies*. A *writ of certiorari* should be issued.

Respectfully submitted,

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APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT FILED MAY 13, 1994

RECOMMENDED FOR FULL-TEXT PUBLICATION
Pursuant to Sixth Circuit Rule 24

ELECTRONIC CITATION: 1994 FED App. 0152P (6th Cir.)
File Name: 94a0152p.06

No. 93-1206

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re: EDWARD W. TOTI,

Debtor.

EDWARD W. TOTI,

Appellant,

v.

UNITED STATES OF AMERICA,

Appellee.

ON APPEAL from the United States District Court for the Eastern District of Michigan

Decided and Filed May 13, 1994

Appendix A

Before: MILBURN and GUY, Circuit Judges; and TIMBERS, Senior Circuit Judge*.

TIMBERS, Senior Circuit Judge. Appellant Toti, a tax debtor, appeals from a January 7, 1993 order entered in the Eastern District of Michigan, Avern Cohn, District Judge. The court reversed an order of the bankruptcy court, Walter Shapero, Bankruptcy Judge, that had allowed Toti to discharge his tax liability by filing for personal bankruptcy.

On appeal, Toti contends that the court incorrectly applied a legal standard that does not require the debtor to act affirmatively to constitute tax evasion, thus denying him a discharge in bankruptcy for his income tax liabilities. Toti also contends that the court erred in concluding that he willfully attempted to evade or defeat his income taxes and therefore was not entitled to a discharge pursuant to 11 U.S.C. § 523(a)(1)(C) (1988).

We affirm.

I.

We summarize only those facts and prior proceedings believed necessary to an understanding of the issues raised on appeal.

From 1974 through 1981, Toti did not file federal income tax returns or pay federal income taxes, despite the fact he knew he was liable for the taxes and he had the wherewithal to pay his taxes during some of those years at least. He claims he did not file his

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* Honorable William H. Timbers, Senior United States Circuit Judge for the Second Circuit, sitting by designation.

returns or pay his taxes in 1974 and 1975 because he did not have sufficient funds at the end of each of those years. For the following six years, he claims he did not file a return because of the penalties and interest accruing due to his failure to file in 1974-75.

In 1981, Toti was indicted on three counts of failing to file federal income tax returns for the years 1974, 1975, and 1976. On June 4, 1981, Toti pleaded guilty. He was convicted and sentenced pursuant to I.R.C. § 7203 for willfully failing to file his 1976 return. The government had agreed to dismiss two counts relating to the tax years 1974 and 1975. In 1982, as part of his sentence, Toti paid in full his 1976 liability and filed all of his delinquent returns. He then filed timely returns for 1982 and 1983, but he did not make estimated quarterly payments or voluntary payments for those years. In April 1985, he negotiated a plan with the Internal Revenue Service (IRS) for payment of his liabilities for 1977 through 1983. Although he initially followed this schedule, he subsequently stopped making payments due to financial inability to pay.

On February 27, 1990, Toti filed a petition for relief pursuant to Chapter 7 of the Bankruptcy Code. He subsequently commenced the instant action seeking, among other things, the determination of the dischargeability of his tax liabilities. The government claimed that he willfully attempted to evade or defeat such taxes, thus making them nondischargeable under § 523(a)(1)(C). The parties filed cross-motions for summary judgment on the dischargeability issue.

On May 22, 1992, the bankruptcy court held that the taxes were dischargeable. In so holding, the court applied a criminal standard to the § 523(a)(1)(C) phrase "willfully attempted in any manner to evade or defeat such tax". This requires the government

to present evidence that the debtor engaged in the willful commission of an act to evade or defeat his tax liability. This is the same standard as in the statute making tax evasion a felony. I.R.C. § 7201. The bankruptcy court held that failing to file a return and make a payment is merely an omission and, since the Bankruptcy Code requires the commission of an act, Toti's omission did not fall within the willfulness standard.

The government appealed to the district court. In a memorandum and order entered on January 7, 1993, the court concluded that the bankruptcy court had applied the wrong legal standard. The court applied the standard used in other civil cases — "voluntary, conscious, and intentional" — to hold that Toti's failure to file returns and to pay taxes were willful acts. The court held that Toti willfully attempted to evade or defeat his tax liability within the meaning of § 523(a)(1)(C). The court reversed and remanded the case to the bankruptcy court for entry of an order consistent with the order of the district court. This appeal followed.

II.

A debtor under Chapter 7 of the Bankruptcy Code generally is granted a discharge from all debts that arose before the filing of the bankruptcy petition. 11 U.S.C. § 727(b) (1988). Section 523, however, provides exceptions to discharge of various debts. At issue here is § 523(a)(1)(C), which provides, in relevant part:

> "(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —
>
> (1) for a tax or a customs duty —

> (C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax".

It was pursuant to this exception that the court held Toti's tax liability was not dischargeable in bankruptcy.

Toti contends that the court applied the wrong standard in holding that his failure to file or pay income taxes was a "willful[] attempt[] . . . to evade or defeat such tax" within the meaning of § 523(a)(1)(C). He asserts that the bankruptcy court applied the correct standard by requiring that a debtor commit an affirmative act of evasion before denying a discharge of tax liability through bankruptcy. We review *de novo* the court's interpretation of the Bankruptcy Code. *In re Batie*, 995 F.2d 85, 88 (6 Cir. 1993).

In support of this contention, Toti points to the language of § 523(a)(1)(C) and analogizes that section of the Bankruptcy Code to language in the Internal Revenue Code. Section § 523(a)(1)(C) closely parallels I.R.C. § 7201 which makes it a felony for a person willfully to attempt to evade or defeat any tax. I.R.C. § 7203, on the other hand, makes it a misdemeanor for any person willfully to fail to pay an estimated tax or the tax itself or fail to file a return. Toti asserts that the I.R.C.'s delineation between commission and omission also should apply to the Bankruptcy Code. Since § 523(a)(1)(C) mirrors § 7201, Toti urges us to hold that a tax liability may be prohibited from a bankruptcy discharge only when the debtor has committed some affirmative act to evade paying taxes. According to Toti, merely failing to file or pay taxes would not rise to the requisite level of criminality for nondischargeability. Since Toti was convicted pursuant to the misdemeanor statute rather than pursuant to the felony statute, he asserts that this should

preclude the court from prohibiting the discharge of his tax liability pursuant to the § 523(a)(1)(C) exception.

The Supreme Court has held that courts should interpret the Bankruptcy Code according to the plain meaning of an individual provision as long as the provision's language is unambiguous. *United States v. Ron Pair Enters.*, 489 U.S. 235, 240 (1989). Where statutory language is not expressly defined, that language should be given its common meaning. *Burlington N. R.R. Co. v. Oklahoma Tar Comm'n*, 481 U.S. 454, 461 (1987). The district court here held that the definition of "willfully attempted to evade" was consistent with the definition found in other civil tax cases, which equates "willful" with voluntary, conscious, and intentional evasions of tax liabilities. *Collins v. United States*, 848 F.2d 740, 742 (6 Cir. 1988); *Domanus v. United States*, 961 F.2d 1323, 1326 (7 Cir. 1992). We believe that a plain reading of § 523(a)(1)(C) includes both acts of commission and acts of omission.

As the district court stated, "the purpose of the Bankruptcy Code is to allow the honest debtor a fresh start". *United States v. Toti*, 149 B.R. 829, 834 (E.D. Mich. 1993). Toti does not fall within the category of honest debtors. He had the wherewithal to file his return and pay his taxes, but he did not fulfill his obligation. It is undisputed that he did so voluntarily, consciously, and intentionally.

We agree with the district court's holding that Toti willfully attempted to evade or defeat his tax liability within the meaning of § 523(a)(1)(C) and that his debt was not discharged by his bankruptcy.

Appendix A

III.

To summarize:

The district court correctly held that failure to file a tax return and failure to pay a tax fall within the definition in § 523(a)(1)(C) of a willful attempt to evade or defeat a tax liability. The court also correctly held that Toti willfully attempted to evade or defeat his tax liability.

Affirmed.

APPENDIX B — OPINION OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MICHIGAN DATED JANUARY 7, 1993

UNITED STATES of America, Appellant,

v.

Edward TOTI, Appellee.

Civ. A. No. 92-73870.

United States District Court,
E.D. Michigan, S.D.

Jan. 7, 1993.

* * *

Mark Lansing, U.S. Dept. of Justice, Washington, DC, for U.S.

Paul Steinberg, Southfield, MI, for Toti.

MEMORANDUM AND ORDER

I.

COHN, District Judge.

This is a bankruptcy appeal by the United States of America (the Government) from a decision of the Bankruptcy Court granting Edward Toti's (Toti) motion for summary judgment in an adversary proceeding. The Bankruptcy Court ruled that Toti's

federal income tax liability was dischargeable in his Chaper 7 case because he did not willfully attempt to evade or defeat the payment of his federal income taxes.[1] The Government contends that the Bankruptcy Court incorrectly adopted a criminal definition of the phrase "willfully attempted to evade" under 11 U.S.C. § 523(a)(1)(C) and applied it in this civil bankruptcy proceeding. In the alternative, the Government argues that even if the Court determines that the criminal definition is appropriate, the bankruptcy judge made findings of fact which precludes a grant of summary judgment.

For the reasons stated below, the Court finds that the Bankruptcy Court erred in its application of the criminal definition of "willfully attempted to evade" to a civil bankruptcy discharge case. Therefore, the decision of the Bankruptcy Court is REVERSED. The case is REMANDED to the Bankruptcy Court for entry of an order consistent with this decision.

II.

The parties have stipulated that the following facts are not in dispute:

1. Toti failed to timely file federal income tax returns for the years 1974 through 1981.

2. Toti has unpaid federal income tax liabilities for the years 1974 through 1983 (except 1976, which liability was previously paid in accord with a sentence and probation order following Toti's conviction on June 4, 1981 for wilful failure to file an income tax return for the year 1976, pursuant to 26 U.S.C. § 7203).

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1. *Matter of Toti*, 141 B.R. 126 (Bkrtcy.E.D Mich. 1992).

Appendix B

3. Toti failed to make any voluntary payments towards any of these federal income tax liabilities during the tax years in question, or prior to his criminal conviction on June 4, 1981.

4. Toti knew he was required to pay the tax liabilities as they arose during each of the years in question.

5. Toti knew in 1977 that the Internal Revenue Service (IRS) was conducting a criminal investigation with respect to his failure to file income tax returns and pay the income tax liabilities.

6. After having knowledge of the IRS criminal investigation, Toti did not file his federal income tax returns or make payments on his federal income tax liabilities for the years prior to or subsequent to that investigation, up to and including 1991.

7. Toti timely filed his federal income tax returns for 1982 and 1983.

8. Toti knew he had federal income tax liabilities for each of the years in question and he had that knowledge with respect to each tax year's liabilities during each of the years in question.

9. Toti made no effort to pay those tax liabilities until after he served his confinement pursuant to his conviction and sentence order of June 4, 1981, which directed him to make restitution for 1976, the year for which he plead guilty.

10 Toti knew he had a responsibility to file federal income tax returns for each year in question, at the time they were statutorily required to be filed.

11. Toti knew he was required to make estimated quarterly

tax payments with respect to his federal income taxes during each year in question, and admits that he failed to do so for each quarter of each year in question.

12. Toti states that he failed to file federal income tax returns and pay his year end federal income tax liabilities because he did not have sufficient funds at the end of the respective years in question.

13. Toti failed to set aside any money during each of the respective years in question to make the required estimated quarterly payments.

14. Toti had a profit from his business as an insurance agent.

15. Toti had no other debts or liabilities that precluded him from making the tax payments.

16. In 1981, the United States indicted Toti on three counts pursuant to 26 U.S.C. § 7203 for failure to file federal income tax returns for the years 1974, 1975, and 1976. On June 4, 1981, Toti was convicted and sentenced as a result of a Plea Agreement by the United States District Court for the Eastern District of Michigan for wilfully failing to file federal income tax returns for the years 1974, 1975 and 1976.

17. Pursuant to the Plea Agreement, Toti agreed to plead guilty to wilfully failing to file an income tax return for the year 1976 only. In return, the Government agreed to dismiss Counts I and II, which concerned his failure to file federal income tax returns for the years 1974 and 1975.

18. Pursuant to the sentencing and probation order, Toti was

required to file all his delinquent federal income tax returns and pay the federal income tax liability for the year 1976. Toti has complied with that order.

19. In April, 1985, Toti and the IRS agreed to a payment plan for the payment of the unpaid back taxes.

20. Toti made some payments to the IRS but fell behind due to his inability to meet those payments and stopped making payments.

21. On February 27, 1990, Toti filed a Chapter 7 petition in the United States Bankruptcy Court. On March 28, 1990, Toti filed an adversary proceeding to determine the dischargeability of his tax obligations. The parties filed cross motions for summary judgment.

22. The Bankruptcy Court decided that in favor of Toti, holding that his income tax liabilities were dischargeable.

III.

The scope of the Court's authority on this appeal is set by Bankruptcy Rule 8013:

> On an appeal, the district court or bankruptcy appellate panel may affirm, modify, or reverse a bankruptcy judge's judgment, order or decree or remand with instructions for further proceedings. Findings of fact whether based on oral or to documentary evidence shall not be set aside unless clearly erroneous alld due regard shall be given to the opportunity of the

> bankruptcy court to judge the credibility of the witnesses.

The Court may not set aside findings of fact unless they are clearly erroneous. Fed.R.Civ.P. 52(a). However, questions of law are reviewed de novo. *In re Caldwell*, 851 F.2d 852 (6th Cir.1988). Here, the issue on appeal is solely a question of law.

A.

Exceptions to the discharge of a tax debt are addressed in 11 U.S.C. 523(a)(1)(C) which provides, in relevant part:

> (a) A discharge under Section 727, 1141, 1288(a), 1288(b) or 1328(b) of this title does not discharge an individual debtor from any debt
>
> (1) for a tax or customs duty
>
> (C) with respect to which the debtor made a fraudulent return or willfully attempted . . . to evade or defeat such tax.

The dispute here revolves around the definition of the phrase "willfully attempted to evade" as used in 11 U.S.C. § 523(a)(1)(C). The Bankruptcy Court adopted the accepted definition of like words in 26 U.S.C. § 7201.[2] That section, the felony tax evasion

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2. 26 U.S.C. § 7201 provides:

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the

(Cont'd)

provision, requires three elements: (1) willfulness, (2) failure to pay the tax when due, and (3) an affirmative act constituting an evasion or attempted evasion of the tax. *Sansone v. United States,* 380 U.S. 343, 351, 85 S.Ct. 1004, 1010, 13 L.Ed.2d 882 (1965). The Bankruptcy Court held that in order to constitute a willful attempt to evade a tax under 11 U.S.C. § 543(a)(1)(C), the debtor must have engaged in some type of affirmative action, some type of commission. *Matter of Toti, supra,* at 130, 131. An omission, the Bankruptcy Court held, is insufficient to constitute a willful attempt to evade or defeat. *Id.*

The Bankruptcy Court concluded that: (1) the government did not present any evidence to indicate that Toti engaged in any act of willful commission to evade or defeat the tax; (2) the fact that Toti admitted he knew he had a responsibility to timely file and pay his taxes and that he voluntarily and intentionally failed to file or pay them as an initial result of lack of money and eventually fear of filing subsequent returns, merely constitutes an omission; (3) no facts indicate that Toti engaged in any type of conduct which would prove he attempted in any manner to evade or defeat his federal income tax; and (4) absent such proof, the IRS could not prove that Toti met the requirements of 26 U.S.C. § 7201 or 11 U.S.C. § 523(a)(1)(C).

IV.

The Government contends that the Bankruptcy Court erred in applying the identical definition of "willfully attempted to evade"

(Cont'd)

> payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined no more than $100,000 . . . or imprisoned not more than 5 years, or both . . .

to bankruptcy discharge cases as that contained in 26 U.S.C. § 7201. It argues that the correct definition should be the same as that generally applied in civil tax cases voluntarily, consciously, or intentionally attempted to evade.

A.

Initially, the Government argues that this case turns on statutory interpretation. Any interpretation of a statute begins with the statutory language and the general rules of statutory interpretation. *Pennsylvania Dept. of Public Welfare v. Davenport,* 495 U.S. 552, 110 S.Ct. 2126, 109 L.Ed.2d 588 (1990). The plain meaning of the statute's language should control except in the rare cases in which the literal application of the statute will produce a result demonstrably at odds with the intentions of the drafters. In such cases, the intention of the drafters rather than the strict language controls. *Sells v. United States,* 92-1 U.S.T.C. ¶ 5070; 83,283, 1991 WL 328039 (D.Co.1991) (quoting *United States v. Ron Pair Enterprises,* 489 U.S. 235, 240-241, 242, 109 S Ct. 1026, 1029-30, 1031, 103 L.Ed.2d 290 (1989)).

In *Sells*, a case factually similar, the *Sells* court grappled with the proper standard to apply in a § 523(a)(1)(C) case. The debtor urged the court to adopt the standard enunciated in *In re Gathwright,* 102 B.R. 211 (Bkrtcy.D.Ore.1989), that the phrase "willfully attempted to evade" should be interpreted to require some affirmative act just as it is interpreted in a 26 U.S.C. § 7201 case. The *Sells* court concluded that its decision turned on the definition of the word "evade". "Willful" the Court held, means voluntary and intentional. However, the word "evade" proved more difficult to define. The *Sells* court noted that it is not defined in the Bankruptcy Code. It looked to the dictionary which defines "evade in connection with taxes" to mean "to fail to pay or to

minimize [taxes] in violation of the law." The *Sells* court said, "The IRS asserts that the plain meaning of "evade" includes a debtor's attempt to block the collection of taxes uhich have already been assessed . . . Although the reading proposed by the IRS broadens the scope of the statute, the court is inclined to accept it. Clearly, the phrase "in any manner" which modifies the term "evade" supports this conclusion." *Sells, supra.*

The *Sells* court concluded that reading the statute as proposed by the debtor contradicted the primary purpose of the Bankruptcy Code, to allow the *honest* debtor a fresh start. The *Sells* court took guidance from an earlier bankruptcy decision, *In re Jones,* 116 B.R. 810, 815 (Bkrtcy.Kan.1990) in which the bankruptcy court held that a civil standard was the appropriate standard to apply to bankruptcy discharge cases. In *Jones,* the bankruptcy court had misgivings about using a criminal statute as the basis for applying a restrictive reading to a civil statute, even though exceptions to discharge are to be strictly construed in favor of the debtor. *Id.* at 815. The *Jones* bankruptcy court examined the legislative history of the comparable provision of the Bankruptcy Act, § 17(a)(1)(d) and stated,

> Prior to 1966, debts for taxes were not affected by a discharge in bankruptcy at all. In discussing the 1966 amendment to § 17(a)(1), Congress said, "Since the purpose of this bill is to provide relief for the financially unfortunate and not to create a tax evasion device, [§ 17(a)(1)] specifically excepts from discharge taxes . . . with respect to which [the bankrupt] had made a false or fraudulent return or which he had otherwise attempted to evade." [citations omitted].

Appendix B

> . . . If willful attempts to evade or defeat the collection of taxes do not satisfy § 523(a)(1)(C), then these debtors have discovered a most lucrative device, one which would allow them to defeat the collection of over $300,000 in taxes.

Id. Other bankruptcy courts have similarly found that a civil definition of "willfully attempt to evade" is the proper standard in a 11 U.S.C. § 523(a)(1)(C) action. *In re Fernandez,* 112 B.R. 888 (Bkrtcy.N.D.Ohio 1990); *In re Berzon,* 145 B.R. 247 (Bkrtcy. N.D.Ill.1992); *In re Langlois,* No. 91-91194 (Bkrtcy. S.D.N.Y.1992).

B.

The Government also argues that this case should be analogized to the one hundred percent penalty cases. 26 U.S.C. § 6672.[3] In these cases, the decisions do not rely on the criminal definition of willful as set forth in 26 U.S.C. § 7202, the criminal counterpart to 26 U.S.C. § 6672. Rather, the decisions hold that the term "willful" as used in ^ 6672 refers to voluntary, conscious, and intentional — as opposed to accidental — decisions not to remit funds properly withheld to the Government. *Monday v. United States,* 421 F.2d 1210 (7th Cir. 1970), *cert. denied,* 400 U.S. 821, 91 S. Ct. 38, 27 L.Ed.2d 48 (1970). The Court of Appeals for the Sixth Circuit has held that "willful" in civil proceedings does not mean that the taxpayer acted by virtue of a bad motive or the specific intent to defraud the government or to deprive it of

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3. 26 U.S.C. § 6672 imposes personal liability on those individuals within a corporation who are responsible for paying over withholding taxes to the government and who willfully fail to do so. *Domanus v. U.S.,* 961 F.2d 1323 (7th Cir 1992).

revenue even though deprivation of revenue was the outcome of the taxpayer's actions. *Calderone v. United States, supra; Gephart v. United States, supra;* and *Collins v. United States, supra.*

In *Domanus v. United States*, 961 F.2d 1323, 1326 (7th Cir.1992), the court was asked to reject the definition of "willfulness" as established in *Monday* in favor of app]ying a criminal standard, that the government must prove an intentional violation of a known legal duty. The court re-examined its holding in *Monday,* and stated,

> In reaching our holding (in *Monday),* we stated "[i]n crirninal statutes wilifulness generally requires bad purpose or the absence of any justifiable excuse . . . In civil actions, however, these elements need not be present. Rather willful conduct denotes intentional, knowing and voluntary acts." [citations omitted]. Accordingly, we stated that the jury should have been instructed that an act is willful if it is voluntary, conscious and intentional . . .
>
> Despite Domanus' valid assertions that the effects of § 6672 can be harsh, we can divine no legal basis to alter the definition of "willfully" set forth in *Monday.*

Other courts have reached the same conclusion. *See, Collins v. United States,* 848 F.2d 740 (6th Cir.1988) (A responsible person who makes a deliberate choice to voluntarily, consciously and intentionally pay other creditors rather than make tax payments is liable for willful failure); *Kinnie v. United States,* 771 F.Supp. 842 (E.D.Mich.1991) (Knowledge of and the failure to pay the liability

when due is all that is necessary to establish willfulness as a matter of law); *In re Fernandez,* 130 B.R. 757 (Bkrtcy.W.D.Mich.1991) (A responsible person willfully fails to pay when the individual makes a deliberate choice to voluntarily, consciously, and intentionally pay other creditors rather than pay the taxes). *See also, In re Calderone,* 799 F.2d 254 (6th Cir.1986) and *Gephart v. United States,* 818 F.2d 469 (6th Cir1987).

The Government urges the Court to define "willful attempt to evade or defeat taxes" as any voluntary, intentional or conscious attempt to avoid or to fail to pay taxes. Since the Bankruptcy Court found, and the parties do not dispute, that Toti knew he had a responsibility to timely file and to pay his federal income taxes for the years 1974-1983 and that he voluntarily and intentionally failed to file and pay those taxes, the Government contends it is clear that Toti voluntarily, intentionally, and consciously attempted to evade and defeat the payment of his taxes and therefore, "willfully attempted in any manner to evade or defeat such tax."

C.

Toti argues that the Bankruptcy Court did not apply a criminal standard to this case. He notes that the Bankruptcy Court applied a preponderance of the evidence standard as required by *Grogan v. Garner,* 498 U.S. 279,111 S.Ct. 654,112 L.Ed.2d 755 (1991). Further, he claims that definition of the word "willful" was not material to the Bankruptcy Court decision and that the Bankruptcy Court did not specifically define willfulness because Toti committed no act upon which the Bankruptcy Court could find any attempt to evade or defeat taxes. Rather, Toti says, the Bankruptcy Court properly adopted the definition and rationale of *In re Gathwright,* 102 B.R. 211 (Bkrtcy.D.Ore.1989). In *Gathwright,*

the court concluded that "willfully attempted to evade" in 11 U.S.C. § 523(a)(1)(C) should be interpreted in the same way as 26 U.S.C. § 7201, thus requiring a showing of some willful commission. The government in *Gathwright* failed to provide any evidence of a willful commission and the court discharged the debtor's tax liability. Toti contends that the government here failed to produce any evidence of a willful commission and therefore, the Bankruptcy Court correctly found his tax liability dischargeable.

V.

The Court, after careful consideration of the parties' briefs, the record and the relevant case law, finds that the proper definition of "willfully attempted to evade" in the context of an 11 U.S.C. § 523(a)(1)(C) discharge case is that found in other civil tax cases —voluntary, conscious and intentional. There is no requirement of an affirmative act or commission as suggested by Toti. As *Jones* and *Domanus* indicate, the purpose of the Bankruptcy Code is to allow the honest debtor a fresh start. One who fails to file tax returns and pay his income tax liability when financially able to meet those obligations hardly qualifies as an honest debtor. The Court should not allow government machinery, constructed to assist honest debtors experiencing severe financial difficulties, to be used to manipulate a fraud.

Here, it is undisputed that Toti failed to file tax returns or pay taxes until he was forced to do so as part of the terms of his sentence. While his failure to pay was initially due to an inability to pay, he later was financially able to meet his obligations and failed to do so. As a result, he now owes over $600,000 in taxes. To the extent these taxes continue unpaid, the burden on other taxpayers is increased.

Appendix B

Toti's failure to file and pay was done with knowledge of a duty under the law to file and pay his taxes and was voluntary, conscious and intentional. Accordingly, Toti willfully attempted to evade or defeat his tax liability as defined in 11 U.S.C. § 523(a)(1)(C)

SO ORDERED.

APPENDIX C— OPINION OF THE UNITED STATES BANKRUPTCY COURT, EASTERN DISTRICT OF MICHIGAN DATED MAY 22, 1992

In the Matter of Edward TOTI, Debtor.

Edward TOTI, Plaintiff,

v.

UNITED STATES of America,
Defendant.

Bankruptcy No. 88-05085.
Adv. Pro. No. 90-0191-S.

United States Bankruptcy Court,
E.D. Michigan, S.D.

May 22, 1992.

* * *

Paul H. Steinberg, Goldstein, Bershad, Steinberg & Fried, P.C., Southfield, Mich., for plaintiff.

Mark D. Lansing, Trial Atty., Tax Div., U.S. Dept. of Justice, Ben Franklin Station Washington, D.C., for defendant.

OPINION IN RESPECT TO CROSS-MOTIONS FOR SUMMARY JUDGMENT

WALTER SHAPERO, Bankruptcy Judge.

I. FACTUAL BACKGROUND

The debtor Edward W. Toti ("Toti") is a self-employed independent insurance agent. From 1961 to 1973 Toti timely filed

all of his federal income tax returns and paid any and all such taxes owing to the Internal Revenue Service ("IRS"). In 1974, due to his inability to pay his federal income tax liability for that year, Toti did not file a return. In 1975, Toti again was unable to pay his federal income tax liability for the year and did not file a return. Primarily as a result of the penalties and interest that were accruing on prior tax liabilities, Toti became fearful of the consequences that might result from the filing of subsequent returns and thus failed to do so through 1980. In 1981, the United States ("Government") indicted Toti on three (3) counts for failure to file federal income tax returns for the years 1974, 1975 and 1976.

On June 4, 1981, Toti was sentenced, as a result of a plea agreement, by the United States District Court for the Eastern District of Michigan for willfully failing to file returns for the years 1974, 1975 and 1976 pursuant to 26 U.S.C. § 7203, a misdemeanor statute. Pursuant to the plea agreement, Toti agreed to plead guilty to willfully failing to file an income tax return for the year 1976, in return for the Government dismissing Counts I and II, representing the years 1974 and 1975.

In 1982, following his conviction, Toti filed all of his delinquent federal tax returns for 1974-1981 inclusive but only paid his 1976 federal tax liability. He did not pay the tax liabilities for the other years which he filed the delinquent returns. In April, 1985, Toti negotiated a payment plan with the IRS for the payment of the unpaid back taxes. Toti made some timely payments but fell behind and then the IRS began levying on his pension income, causing him serious financial difficulties.

On February 27, 1990, Toti filed a Chapter 7 petition in the United States Bankruptcy Court. On march 28, 1990, Toti filed an

adversary proceeding[1] to determine the dischargeability of tax obligations for unpaid federal income taxes for the tax years 1975 through 1983, excluding the year 1976 (which he paid) and to require the IRS to turn over the funds in the amount of $4,464.39 levied upon post-petition. Toti also seeks damages against the IRS for violation of the automatic stay by reason of its post-petition actions in levying on his pension income. In an answer filed on April 24, 1990, the IRS asserts (a) that tax liabilities for the years 1974 through 1983 (excluding the year 1976), are nondischargeable under § 523(a)(1)(C) and (b) it cannot be sued for stay violation damages because the Government has not waived its sovereign immunity in respect to such an action.

Both parties filed motions for summary judgment on the issue of dischargeability under § 523(a)(1)(C). In addition, the IRS moved for summary judgment on the issue of sovereign immunity.

II. DISCUSSION

A. Standards Used in Granting or Denying Motions for Summary Judgment

Motions for summary judgment should not be granted unless no genuine issue of material fact remains to be decided and the moving party is entitled to judgment as a matter of law. *In re Fernandez*, 130 B.R. 757 (Bankr. W.D. Mich. 1991). The function of a motion for summary judgment is not to allow the court to decide issues of fact but rather to determine whether there is an issue of fact to be tried. *United States v. Articles of Device, Ect.* 527 F.2d 1008, 1011 (6th Cir. 1976); *Aetna Ins. Co. v. Cooper Wells &*

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1. In the case of tax obligations, it is the burden of the debtor, rather than the taxing authority, to initiate a discharge action. 11 U.S.C. § 523(c); Fed.R.Bankr.P. 4007(c).

Co., 234 F.2d 342, 345 (6th Cir. 1956). The moving party bears the burden of clearly establishing the nonexistence of any genuine issue of fact material to a judgment in his favor. *Fernandez* at 761. If a disputed question of material fact remains, the motion for summary judgment must be denied. *Id.* Thus, the court must examine all facts established by the record before it and conclude that no genuine issue of material fact exists before granting summary judgment.

B. Dischargeability of Federal Taxes

Under Bankruptcy Code § 523(a)(1)(B)(ii) a delinquent return filed within two (2) years prior to the filing of a bankruptcy case renders nondischargeable the taxes for tax years to which those returns apply. Although Toti's tax liability could be dischargeable since he filed all the delinquent tax returns in 1982 (eight (8) years prior to filing a Chapter 7 petition), long before the time frame prescribed by the Code, the IRS asserts that pursuant to Code § 523(a)(1)(C), the tax liability is excepted from discharge.

Code § 523(a)(1)(C) provides as follows:

> § 523. Exceptions to discharge.
>
> (a) A discharge under Section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> (1) for a tax or a customs duty—
>
> (C) with respect to which the debtor made a fraudulent return or willfully

> attempted in any manner to evade or defeat such tax;

The IRS asserts that Toti's decision not to pay the taxes for the tax years 1974 through 1983 (excluding the tax year 1976), (even though he filed the returns) evidences the willfulness necessary to (a) convict the debtor for felonious criminal willfulness to evade or defeat a tax, and (b) the willfulness which afforded the basis for his plea to evade or defeat a tax, required under Code § 523(a)(1)(C).

Toti asserts that his indictment for failure to file federal income taxes for the years 1974 through 1976 and his plea of guilty for failure to file a federal tax return for 1976 is proof only that he failed to file.

Toti contends that the language of Code § 523(a)(1)(C) is similar to § 7201 of Title 26 of the United States Code, a felony statute or criminal evasion of taxes, which reads:

> 26 U.S.C.A. § 7201. Attempt to evade or defeat tax.
>
> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.

Toti was charged and convicted of failure to file his federal tax

return, for the year 1976, under Section 7203 of Title 26 of the United States Code, a misdemeanor, which reads in pertinent part:

> 26 U.S.C.A. § 7203. Willful failure to file return, supply information, or pay tax
>
> Any person required under this title to pay any estimated tax or tax, or required by this title or by regulations made under authority thereof to make a return, keep any records, or supply any information, who willfully fails to pay such estimated tax or tax, make such return, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than $25,000 ($100,000 in the case of a corporation), or imprisoned not more than 1 year, or both, together with the costs of prosecution.

Toti asserts essentially that the requirements necessary to show a willful attempt to evade or defeat the payment of income taxes under § 523(a)(1)(C), are those contemplated *only* by the felonious offense of willful attempt to evade or defeat the payment of income taxes under § 7201. Toti argues, the conviction under the misdemeanor offense of willful failure to pay taxes or file returns, pursuant to § 7203, involves a lesser burden of proof or finding that a willful attempt to evade or defeat under § 7201.

Therefore, Toti claims the IRS has no basis for its assertion that Toti *willfully* attempted to evade his federal income tax

liabilities for those years, and as such, Toti is entitled to a discharge of his tax obligations for the tax years 1974 through 1983.

It is undisputed that § 7203 defines a lesser included offense of § 7201. *U.S. v. DeTar*, 832 F.2d 1110 (9th Cir. 1987). The elements of § 7203 are: (1) willfulness and (2) failure to pay the tax when due. *Sansone v. United States*, 380 U.S. 343, 351, 85 S. Ct. 1004, 1010, 13 L. Ed. 2d 882 (1965). Section 7201 requires the same two (2) elements of willfulness and an unpaid tax, plus a third: an affirmative act constituting an evasion or attempted evasion of the tax. *Id.*

It would seem that the word or concept of willfulness embodied in § 7201 (felony) and § 7203 (misdemeanor) is:

(a) a uniform one;

(b) connotes a voluntary intentional violation of a known legal duty; and

(c) a conviction of the misdemeanor clearly supports a conviction for the felony, insofar as the willfulness element is concerned. *See e.g.*, *United States v. Bishop*, 412 U.S. 346, 93 S. Ct. 2008, 36 L. Ed. 2d 941 (1963); *United States v. Pomponio*, 429 U.S. 10, 97 S. Ct. 22, 50 L. Ed. 2d 12 (1976); *Cheek v. United States*, __U.S.__, 111 S. Ct. 604, 112 L. Ed. 2d 617 (1991); *Sansone v. United States*, 380 U.S. 343, 85 S. Ct. 1004, 13 L. Ed. 2d 882 (1965).

The issue in this case is whether the facts establish by a preponderance of the evidence that Toti willfully attempted to

evade or defeat his federal income tax liability within the meaning of § 523(a)(1)(C).

Review of Supreme Court case law on the above issue and the sameness of the statutory language convinces the Court (in agreement with Toti) that the phrase "willfully attempted in any manner to evade or defeat such tax" in § 523(a)(1)(C) should be interpreted to mean and contain the same elements as specified in § 7201.

The Supreme Court has made it clear that a conviction for a felony of tax evasion under § 7201 requires a showing of "some willful *commission* in addition to the willful omissions that make up the list of misdemeanors." *Spies v. United States*, 317 U.S. 492, 499, 63 S. Ct. 364, 368, 87 L. Ed. 418 (1943).

In *Spies*, Spies failed to file a return or pay a tax in a year in which he admittedly had sufficient income to require him to do both. The issue with which the Supreme Court dealt was whether this conduct could constitute a willful attempt to evade under what is now § 7201. The Court held that without other proof, it could not. The court referred to the statutory provision that willful failure to file or to pay are misdemeanors, and concluded that a willful attempt to evade, in order to constitute a felony, must logically be something more. The Court then reasoned that this "is found in the affirmative action implied from the term 'attempt' as used in the felony subsection." *Spies*, 317 U.S. at 498, 63 S. Ct. at 368. The Court stated:

> We think . . . Congress intended some willful commission in addition to the willful omissions that make up the list of misdemeansor. . . . [W]e would think

> afffirmative willful attempt may be inferred from conduct such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or conceal. *Spies*, 317 U.S. at 499, 63 S. Ct. at 368.

The *Spies* list of illustrations may be read as suggesting that the required acts of commission should be of such a character as is likely to mislead or conceal, and thus hinder detection and, should do more than is done *by a simple* omission.

Although the decision by the Supreme Court in *Spies* does not address § 7201 in relation to dischargeability under § 523(a)(1)(C), bankruptcy court case law relied upon *Spies* to do so.

In *In re Gathwright*, 102 B.R. 211 (Bankr. D. Or. 1989), the debtor sought a determination that certain taxes and penalties assessed by the Internal Revenue Service ("IRS") were discharged in his Chapter 7 case.

Debtor asserted that he failed to timely file his federal income tax returns for the years 1976, 1978 and 1979 as a result of financial difficulties. Testimony indicated that at the time the tax returns at issue were due, and continuing until they were filed, debtor was under extreme financial pressure, his wife suffered from medical problems and he was involved in an automobile accident that adversely affected his eyesight and thus, his ability to work.

Appendix C

In determining whether the debtor's tax liability was nondischargeable under § 523(a)(1)(C), the Court, relying upon *Spies*, agreed with the IRS that the Code phrase "willfully attempted in any manner to evade or defeat such tax" should be interpreted in the same way as § 7201. *Id.* at 213.

The Court relied upon the illustrations set forth in the *Spies* case to determine whether any affirmative willful attempt could be inferred from the debtor's conduct. The court concluded that the IRS did not prove that the debtor engaged in any willful conduct to evade or defeat the tax under § 523(a)(1)(C).

The Court found that the IRS' testimony indicated that (1) the debtor did not refuse IRS' request to turn over his records and books, or destroy them; (2) debtor did not hide income in undisclosed accounts; and (3) debtor's books and records were sufficient to allow a determination of the tax liability owed. The Court held, at most "his debt to the IRS is a result of sloppy or negligent conduct, not fraudulent or willful conduct." *Id.* at 216. Thus, the Court held that the debtor's tax liability was dischargeable.

This Court concludes that the IRS did not present any evidence to indicate that Toti engaged in any willful *commission* to evade or defeat the tax. The fact that Toti admits he knew he had a responsibility to timely file and pay federal income tax for the years 1974-1983 and that he voluntarily and intentionally failed to file and pay those taxes as an initial result of lack of money and eventually fear of filing subsequent returns, merely constitutes an omission. No facts indicate that Toti engaged in any type of conduct which would prove he attempted in any manner to evade or defeat his federal income tax. Absent such proof, the IRS cannot satisfy the requirements under § 7201 or § 523(a)(1)(C) and Toti is

entitled to have his tax obligations for the years 1974 through 1983 discharged. Therefore, Toti's motion for summary judgment, with respect to this issue, is granted.

C. Violationof the Automatic Stay and Sovereign Immunity

Toti asserts that subsequent to the filing of the Bankruptcy petition, the IRS levied upon and seized on four (4) separate occasions, post-petition pension plan payments and post-petition commissions payable[2] to Toti in clear violation of the automatic stay.

Pursuant to § 362, Toti states the IRS has an obligation to restore the pre-petition status quo by returning the improperly seized property to Toti.

Toti claims that the IRS' failure to comply with the automatic stay, and its failure to restore the status quo voluntarily also subjects the IRS to the contempt powers of the Court.

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2. Toti contends the pension plan payments and commissions were seized on or about the following dates and in the following amounts:

Date		Amount
March 1, 1990		$1,500.00
March 6, 1990		167.31
March 12, 1990		1,640.00
March 13, 1990		1,157.08
	Total	$4,464.39

Appendix C

In response, the IRS asserts that this Court is without jurisdiction to award damages (either compensatory or punitive) or attorney's fees against the IRS under § 362(h) because it has not waived its sovereign immunity[3] for such an action. In addition, the IRS claims that assuming, *arguendo,* sovereign immunity is not a bar to an award of attorneys fees under § 362(h), the Court would err in awarding costs and attorney's fees since Toti was not injured by violation of the stay.

Examination of the pleadings submitted in this matter indicate that there is a factual dispute as to when the pension plan payments and commissions were seized from Toti. As referenced above in Footnote 3, Toti claims that IRS seized four (4) post-petition amounts. On the other hand, the IRS asserts that it received only one (1) payment, on March 23, 1990, subsequent to the time of the filing of the bankruptcy petition. The Court believes that as long as the parties are in agreement that there was at least one (1) post-petition transfer, it is unnecessary to determine the precise amount for purposes of the issue as to whether the IRS violated the automatic stay.

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3. Section 106 of the Bankruptcy Code addresses the waiver of sovereign immunity by "Governmental units' in bankruptcy cases:

106. Waiver of Sovereign Immunity

(a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.

(b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

(c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity—

(1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and

(2) a determination by the Court of an issue arising under such a provision binds governmental units.

Appendix C

The Sixth Circuit holds that actions taken in violation of the automatic stay are void *ab initio*. See *In re Smith*, 876 F.2d 524 (6th Cir. 1989); *NLRB v. Edward Copper Painting, Inc.*, 804 F.2d 934 (6th Cir. 1986). Such actions, regardless of notice of the filing, are void and of no effect. *Id.*

It is quite clear to the Court that application of the law in the Sixth Circuit to either parties factual assertions indicates that the payment(s) seized by the IRS were post-petition and in violation of the stay.

As a result of the IRS' violation of automatic stay, Toti seeks to hold the IRS in contempt and to recover his costs, interest and attorneys fees.

Civil contempt sanctions may be imposed even in the absence of willfulness. *In re Shafer*, 63 B.R. 194 (Bankr. D. Kan. 1986). In addition, accidental, inadvertent or negligent conduct can be grounds for imposing civil contempt sanctions, and those sanctions may include attorney fees. *Id.*

A stay violation is willful when the party acts with knowledge of the filing of the bankruptcy. In the present case, Toti filed his bankruptcy petition on February 21, 1990. On March 2, 1990, the IRS stated it received notice of the § 341 Hearing. However, the IRS did not release the levies until April 2, 1990.

A creditor must release the levy within a reasonable period of time after notice of the bankruptcy. *In re Carlsen*, 63 B.R. 706, 710 (Bankr. C.D. Cal. 1986). The Court concludes that the IRS did not act within a reasonable period of time in releasing the levies. Facts presented by the IRS show that on March 30, 1990, when the IRS received a copy of the dischargeability complaint, it assigned an

agent to the case who contacted the revenue officer to release the levies on April 2, 1990. However, the IRS' receipt on March 2, 1990 of the notice of § 341 Hearing was its notice of the bankruptcy and the effect of the stay. *In re Price,* 103 B.R. 989 (Bankr. N.D. Ill. 1989); *In re Wagner,* 74 B.R. 898 (Bankr. A.D. Mo. 1988). The IRS must be charged with the knowledge of its agents. *Price* at 993. The size and complexity of the IRS does not excuse its disregard for the automatic stay. *In re Santa Rosa Truck Stop, Inc.,* 74 B.R. 641, 643 (Bankr. N.D. Fla. 1987).

Thus, the circumstances warrant imposition of monetary civil contempt sanctions to compensate Toti.

The principal defense of the IRS against such is that it is protected by virtue of the sovereign immunity of the United States which it asserts has not been waived. The IRS contends that the United States Supreme Court opinion in *Hoffman v. Connecticut Dep't of Income Maintenance*, 492 U.S. 96, 109 S. Ct. 2818, 106 L. Ed. 2d 76 (1989) made it clear that the United States is not subject to awards of damages under § 106(c).[4]

The Court believes the IRS' reliance is inappropriate. The holding in *Hoffman* does not apply to the federal government. See *In re Price*, 103 B.R. 989 (Bankr. N.D. Ill. 1989). Rather, the Supreme Court decided the issue of whether § 106(c), the sovereign immunity provision, violated the 11th Amendment immunity of states. Important dicta is contained in a statement by the plurality which notes that "the language in § 106(c) waives the

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4. Section 106(c) abolishes the defense of sovereign immunity in cases where suit is brought under a provision of the Bankruptcy Code that uses the words "creditor," "entity," or "governmental unit." The automatic stay, by the term of § 362 is applicable to all entites.

sovereign immunity of the federal government so that the federal government is bound by determinations of issues by the Bankruptcy Courts even when it did not appear and subject itself to the jurisdiction of theCourt." (Citation omitted) *Hoffman* 109 S.Ct. at 2823.

In addition, the IRS relied upon the Sixth Circuit Court of Appeals case *In re Nordic Village*, 915 F.2d 1049 (6th Cir. 1990). In *Nordic Village*, the Court considered the question of whether § 106(c) waived the defense of sovereign immunity. The Court held that 11th Amendment considerations are irrelevant when applying § 106(c) to the federal government and the question was merely one of statutory interpretation. The Court held that the IRS could not assert the defense of sovereign immunity. However, on February 25, 1992, the United States Supreme Court, reversing the decision of the Sixth Circuit Court of Appeals, held that § 106(c) did not contain an unequivocal textual waiver of the federal government's immunity from a bankruptcy trustee's claims for monetary relief. The Supreme Court stated that waivers of the government's sovereign immunity had to be unequivocally expressed, and that § 1206(c) failed to establish unambiguously that its waiver extended to monetary claims. In order to construe the entirety of § 106 so that every word had some operative effect (in accordance with the rules of statutory construction), the Court determined that the most feasible interpretation gave § 106(c) the range to permit a bankruptcy court to issue declaratory and injunctive relief, but not monetary relief, against the government. The Court further declined to examine legislative history, for without a clear and unequivocal expression of waiver in the statutory text, it found that such clarity could not be supplied by a committee report.

The Supreme Court's decision makes it apparent to this Court

that the sort of monetary relief requested by Toti, including the post-petition pension plan payments seized by the IRS, must be denied. Therefore, the IRS' motion, with respect to this issue, is granted.

The prevailing parties shall present appropriate orders consistent with this opinion.